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No. 85-2006

IN THE

SUPREME COURT

OF THE
UNITED STATES

OCTOBER TERM, 1985

NATIONAL CAN CORPORATION, et al.,

Appellants,

v.

STATE OF WASHINGTON, DEPARTMENT OF REVENUE,

Appellee.

ON APPEAL FROM THE SUPREME COURT OF THE STATE OF WASHINGTON

MOTION TO DISMISS OR AFFIRM

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QUESTIONS PRESENTED

Washington imposes a tax on the business activities of selling and manufacturing, within the state, measured by the gross proceeds derived from those activities. The tax applies at essentially the same rate and measure to (1) the in-state manufacture of goods sold elsewhere; (2) the in-state sale of goods manufactured elsewhere; and (3) the in-state sale of goods both manufactured and sold in-state.

This case presents the following questions regarding that tax:

(1) May Washington impose its manufacturing tax on goods manufactured in Washington and sold elsewhere if it also imposes its selling tax, at the same rate and measure as the manufacturing tax, on goods both manufactured and sold in Washington?

(2) May Washington impose its selling tax on goods manufactured elsewhere and sold in Washington if it also imposes its selling tax, at the same rate and measure, on goods both manufactured and sold in Washington?

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Appellee, State of Washington, Department of Revenue, moves the Court to dismiss the appeal herein or, in the alternative, to affirm the judgment of the Washington State Supreme Court on the ground that the questions presented are so unsubstantial as to require no further argument.

STATEMENT

National Can Corporation (NCC) challenges the validity of Washington's business and occupation (B&O) taxes paid on its business activities in Washington. We begin by briefly describing the tax and its application to NCC.

I. WASHINGTON'S B&O TAX.

Washington's B&O tax is levied on persons "for the act or privilege of engaging in business activities." Wash. Rev. Code § 82.04.220. J.S. E-1. This case involves taxes on the activities of selling and manufacturing.

Washington imposes a selling B&O tax upon "every person * * * engaging within this state in the business of making sales" either at wholesale or retail. Wash. Rev. Code §§ 82.04.270 and 82.04.250. J.S. E-2 and 4. The measure of the tax is the gross proceeds of Washington sales. The basic rate of the selling tax is .0044.

Washington also imposes a manufacturing B&O tax upon "every person * * * engaging within this state in business as a manufacturer." Wash. Rev. Code § 82.04.240. J.S. E-2. The measure of the tax is "the value of products" manufactured, which is determined by "the gross proceeds derived from the sale thereof." Wash. Rev. Code § 82.04.450. J.S. E-8. The basic rate of the manufacturing tax is also .0044.

At issue in this case is the operation of the so-called "multiple activities exemption," Wash. Rev. Code § 82.04.440. J.S. E-8. Under this statute "persons taxable under [retailing] or [wholesaling] shall not be taxable under [manufacturing] with respect to * * * manufacturing of the product so sold" *i.e.*, of the products actually taxed under the selling B&O tax.

The end result of these statutes is that all products sold and/or manufactured in Washington are subject to one B&O tax, either selling or manufacturing. The measure of that tax (gross proceeds of sale/value of the products) and the rate of that tax (.0044)[1] are essentially identical.

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[1]During part of the period for which NCC seeks a refund a surtax was imposed in addition to the selling and manufacturing B&O taxes. Effective July 1, 1983 the combination of the basic rate (.0044) and the surtax for the wholesaling and manufacturing B&O taxes was .00484. The combination for retailing B&O tax was .00471. Wash. Rev. Code §§ 82.04.240, 82.04.250, 82.04.270, 82.04.2901 and 82.04.2904. J.S. E-2, 4, 6 and 8.

II. APPLICATION OF THE B&O TAX.

NCC challenges the imposition of both selling and manufacturing B&O tax. For this reason NCC represents the basic factual pattern for all the appellants in this case.

NCC sells packaging products throughout the world. These products are manufactured by NCC in twenty-two states, including Washington. J.S. I-1, ¶¶ 2 and 3. In Washington NCC employs appoximately 240 people. These employees are involved in the manufacture of products at plants located in this state. This number also includes NCC's Washington sales office. J.S. I-2, ¶¶ 6, 7 and 8.

During the period January 1, 1980 through December 31, 1984, NCC paid selling B&O tax (wholesaling) of $606,863 on sales of products in Washington that were manufactured elsewhere. J.S. I-2, ¶ 9. NCC seeks a refund of this selling B&O tax.[2]

Also during this period NCC paid manufacturing B&O tax of $372,843 on products manufactured in Washington and sold elsewhere. J.S. I-3, ¶ 10. NCC seeks a refund of this manufacturing B&O tax.[3]

In addition, NCC paid selling B&O tax of $1,800,000 on products *both* manufactured and sold in Washington. NCC did not pay manufacturing B&O tax on these products. NCC does not seek refund of this sum. J.S. I-3, ¶ 11.

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[2]Some of the appellants such as Xerox Corporation seek only refund of selling B&O tax. Xerox sells office equipment throughout the world. None of Xerox's manufacturing is done in Washington. J.S. J-1, ¶ 2. Xerox employs approximately 460 people in Washington engaged in the sales and service of Xerox products. J.S. J-2, ¶¶ 8 and 9. During the period January 1, 1980 through December 31, 1984, Xerox paid Washington selling B&O tax (wholesaling and retailing) in the amount of $1,537,075. J.S. J-3, ¶ 10. Xerox seeks refund of this selling B&O tax and its arguments are identical to those of NCC.

[3]Some of the appellants such as Kalama Chemical, Inc. seek only a refund of manufacturing B&O tax. Kalama sells chemical products. These products are manufactured by Kalama in Washington and New Jersey; however, none of the products manufactured in New Jersey are sold in Washington. J.S. H-1, ¶¶ 2 and 3. Kalama employs approximately 95 people in Washington involved in the management of the corporation and the manufacture of products at Kalama's plant in this

SUMMARY OF ARGUMENT

NCC claims that the selling and manufacturing B&O taxes violate the Commerce Clause of the U.S. Constitution, Art. I, § 8, cl. 3. This claim is based on NCC's contention that the Washington Supreme Court failed to follow the Court's recent decision in *Armco, Inc. v. Hardesty*, 467 U.S. 638 (1984).

It is now established that a state's tax applied to interstate commerce must meet four requirements under the Commerce Clause: (1) there must be a sufficient connection or nexus between the interstate activities and the taxing state; (2) the tax must not discriminate against interstate commerce; (3) the tax must be fairly apportioned; and (4) the tax must be fairly related to the services provided by the state. *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977).

In this case "nexus" is beyond issue owing to NCC's substantial selling and manufacturing activity in Washington. J.S. 5. NCC's substantial activity also ensures that the B&O taxes are fairly related to the services provided by the state and NCC does not claim otherwise in its Jurisdictional Statement.

Washington's B&O taxes are fairly apportioned under standards earlier laid down by this Court and not overturned in *Armco*. See *Standard Pressed Steel Co. v. Department of Revenue of Washington*, 419 U.S. 560 (1975). For example, in 1983 NCC's worldwide sales approximated $1.552 billion. Of this amount, approximately $110 million was allocated to Washington as gross proceeds of sales in this state. J.S. I-3, ¶ 13.

Thus, NCC's claim is reduced to the discrimination prong of the Commerce Clause test and its charge that the

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state. J.S. H-2, ¶¶ 5 and 6. During the period January 1, 1980 through December 31, 1984, Kalama paid Washington manufacturing B&O tax in the amount of $495,612 (including interest). J.S. H-2, ¶ 7. Kalama seeks refund of this manufacturing B&O tax and its arguments are identical to those of NCC.

decision reached below cannot be reconciled with the holding and reasoning of the Court in *Armco*.

This appeal does not present a substantial federal question. The B&O taxes at issue here are materially different from the taxes analyzed by the Court in *Armco*. Therefore, the majority's analysis requires a different result in this case.

Armco involved West Virginia's wholesaling tax. The Court's analysis striking down the tax can be divided into three parts.

First, the Court considered discrimination. 467 U.S. at 642. It ruled that West Virginia's wholesaling tax discriminated because it only applied if the property was manufactured out of the state and imported for sale. There was no wholesaling tax if the property was both manufactured and sold in West Virginia.

The Court's conclusion has no application to Washington's selling B&O tax because *all* Washington sales are subject to the tax. This is true regardless of where the goods are manufactured. Thus, the Washington selling tax, unlike the West Virginia wholesaling tax, does not apply solely to interstate commerce.

The second part of the majority opinion focused on West Virginia's claim that the wholesaling tax was a compensating tax for the manufacturing tax. 467 U.S. at 642-643. Based on its analysis of these taxes, the Court concluded that it was not.

Washington's selling and manufacturing B&O taxes are materially different from West Virginia's taxes in the two areas analyzed by the Court — the rate of the tax and the measure of the tax. The rates of West Virginia's wholesaling and manufacturing taxes were different, .0027 and .0088, respectively. The rates of Washington's selling and manufacturing B&O taxes are virtually identical — .0044.

The measures of West Virginia's wholesaling and manufacturing taxes were also different, if the manufacturing took place partially within and partially without West Virginia. The measure of Washington's selling and

manufacturing taxes is the same — gross proceeds of sale/value of the products.

The dissimilarities in West Virginia's wholesaling and manufacturing taxes led the Court to conclude that they were not compensating taxes. The similarity of Washington's selling and manufacturing B&O taxes compel the opposite conclusion.

The third part of the majority opinion considered West Virginia's argument that Armco be required to prove actual discriminatory impact. 467 U.S. at 644-646. The Court ruled that no actual discriminatory impact need be shown where a tax on its face discriminates against interstate commerce. In this part of the decision the majority makes reference to the concept of "internal consistency."

NCC argues that the selling and manufacturing B&O taxes discriminate against interstate commerce because they lack "internal consistency." Essentially, NCC claims that the majority grafted this concept onto the discrimination prong of the Commerce Clause test.

NCC's argument misconstrues the Court's discussion of internal consistency. The Court did not graft it onto the discrimination prong, and the Court's actual discussion in *Armco* proves it. Indeed, the Court has consistently refused to apply an internal consistency type test to establish discrimination in its decisions both before and *after Armco.*

The Commerce Clause decisions of the Court prohibit a state tax from providing a direct commercial advantage to local business. The selling and manufacturing B&O taxes provide no such advantage for they are neutral. One thousand dollars of goods sold and/or manufactured in Washington are subject to one tax of $4.40 ($1,000 x .0044). Thus, these taxes neither channel the flow of interstate commerce into nor out of Washington.

The decision below is correct both under *Armco* and the Court's prior Commerce Clause opinions on discrimination. Indeed, *Armco,* itself, is consistent with the Court's prior Commerce Clause decisions. The majority neither

overruled any prior opinions of the Court nor announced any new Commerce Clause principles.

ARGUMENT

THIS CASE PRESENTS NO SUBSTANTIAL FEDERAL QUESTION AND THE DECISION BELOW IS CLEARLY CORRECT

I. THE SELLING AND MANUFACTURING B&O TAXES DO NOT DISCRIMINATE AGAINST INTERSTATE COMMERCE.

To establish that no further argument is required in this case, we will examine *Armco* and the discrimination prong of the Commerce Clause test in some detail, as applied to the selling and manufacturing B&O taxes.

A. The Discrimination Test Under The Commerce Clause.

The discrimination test embodies two basic principles. First, the Commerce Clause prohibits a state from imposing a tax "which discriminates against interstate commerce by providing a direct commercial advantage to local business." *Boston Stock Exchange v. State Tax Commission*, 429 U.S. 318, 329 (1977). The Court has identified two kinds of tax systems that violate this principle.

The first improper tax system *discourages* interstate commerce by using discriminatory taxes "to assure that residents trade only in intrastate commerce." *Boston Stock Exchange*, 429 U.S. at 334-335. Thus, a state "may not tax a transaction or incident more heavily when it crosses state lines than when it occurs entirely within the State." *Armco*, 467 U.S. at 642. This is the rationale of the majority in the first part of the *Armco* opinion.

The second prohibited tax system improperly *encourages* interstate commerce by using "discriminatory taxes to assure that nonresidents direct their commerce to busi-

nesses within the State * * * *" *Boston Stock Exchange*, 429 U.S. at 334-335. Under this principle the Court has struck down tax systems which allow an interstate business to reduce its tax burden, in the taxing state, by increasing its business in that state.

For example, in *Westinghouse Electric Corp. v. Tully*, 466 U.S. 388 (1984), a credit to New York's franchise tax was struck down because it reduced a business' tax from $420 to $406 if the business increased its percentage of shipping out of New York from 0 to 100 percent. 466 U.S. at 400 (Table A).[4]

The second principle of the discrimination test is the converse of the first: a state is not prohibited from structuring its tax system "to encourage the growth and development of intrastate commerce and industry" or "to compete with other States for a share of interstate commerce" so long as it does not "discriminatorily tax the products manufactured or the business operations performed in any other State." *Boston Stock Exchange*, 429 U.S. at 336-337. Accord. *Armco* 467 U.S. at 645-646. Thus, states are free to use taxes to encourage growth and compete for commerce so long as the taxes do not (1) assure residents trade only in intrastate commerce or (2) allow an interstate business to reduce its tax burden, in the taxing state, by doing more business there.

B. The Decision Below Sustaining The Selling B&O Tax is Clearly Correct.

Washington's selling B&O tax is the same tax sus-

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[4]Similarly, the Court struck down credits in *Maryland v. Louisiana*, 451 U.S. 725 (1981) and *Boston Stock Exchange*, 429 U.S. 318 (1977) because a business could reduce its taxes, in the taxing state, by increasing its business in that state. In *Maryland v. Louisiana*, a credit made it possible for a business to reduce its Louisiana tax burden from $70 to $35 if it did additional business in Louisiana. 451 U.S. at 757 (n. 28). In *Boston Stock Exchange*, a nonresident making taxable transactions in New York could reduce his or her tax rate by 50 percent if the stock was also sold in New York. If the stock was sold outside New York there was no reduction. 429 U.S. at 324.

tained by this Court in *General Motors Corp. v. Washington*, 377 U.S. 436 (1964), *Standard Pressed Steel*, 419 U.S. 560 (1975), and *Chicago Bridge & Iron Co. v. Washington Department of Revenue*, 98 Wn.2d 814, 659 P.2d 463 (1983), *appeal dism'd*, 464 U.S. 1013 (1983). The decision below, which again sustains the selling tax, is also correct.

1. **Because all Washington sellers pay the selling B&O tax, that tax does not violate Armco.**

In the first part of the *Armco* decision the Court struck down West Virginia's wholesaling tax because it applied only to interstate sales. In the words of the Court:

> The tax provides that two companies selling tangible property at wholesale in West Virginia will be treated differently depending on whether the taxpayer conducts manufacturing in the State or out of it. Thus, if the property was manufactured in the State, no tax on the sale is imposed. If the property is manufactured out of the State and imported for sale, a tax of 0.27% is imposed on the sale price.

467 U.S. at 642.

This is not true in Washington. The selling B&O tax applies to all sales in this state, without regard to where the goods are manufactured. Thus, the majority opinion in *Armco* has no application whatsoever to Washington's selling B&O tax.

NCC concedes that: "Both the out-of-state and in-state manufacturer pay the Washington selling tax." J.S. 8. NCC alleges that there is discrimination because "Washington grants the in-state manufacturer an exemption" and the "out-of-state manufacturer receives no such benefit." J.S. 8. Basically, NCC complains that it does not receive an exemption from a manufacturing tax to which it is not subject.

In fact, in-state and out-of-state manufacturers selling in Washington are treated in an identical manner. The

only benefit an in-state manufacturer receives is an exemption from Washington's manufacturing B&O tax, *if selling B&O tax is paid* on the manufactured goods. This is by reason of the multiple activities exemption, Wash. Rev. Code § 82.04.440. An out-of-state manufacturer selling in Washington is similarly exempt from Washington's manufacturing B&O tax because the manufacturing activity does not take place "within this state." Wash. Rev. Code § 82.04.240.

NCC, itself, proves this point. NCC sells in Washington goods manufactured in this state and elsewhere. J.S. I-2 and 3, ¶¶ 9 and 11. All of these goods are subject to Washington's selling B&O tax. None of these goods are subject to Washington's manufacturing B&O tax. Clearly, the decision below sustaining the selling B&O tax does not conflict with *Armco*.

2. Washington's selling B&O tax does not provide a direct commercial advantage to local business.

The decision below is clearly correct because Washington's selling B&O tax does not provide a direct commercial advantage to local business.

As we have seen, the selling B&O tax does not *discourage* interstate commerce, since all sales in Washington are subject to the tax. Also, the selling B&O tax does not improperly *encourage* interstate businesses to direct their commerce into Washington.

Unlike the tax system struck down in *Westinghouse v. Tully*, 466 U.S. 388 (1984), an out-of-state manufacturer cannot reduce its Washington tax by increasing its business in this state. When NCC manufacturers $1,000 of goods elsewhere and sells them at wholesale in Washington, it pays $4.40 in wholesaling B&O tax ($1,000 x .0044). If NCC moved its manufacturing operations into Washington it would also pay $4.40 on the sale of $1,000 of goods both manufactured and sold here.

In *Boston Stock Exchange*, 429 U.S. 318 (1976), the Court recognized, in dicta, that this kind of equal treatment does not provide a direct commercial advantage to local business. The Court discussed the New York tax system as it existed prior to the 1968 amendments, which the Court ultimately struck down. Under the earlier system, New York imposed a tax on five separate taxable events. The tax applied if any one of the taxable events took place in New York. However, if more than one event took place in New York, only one tax was due. 429 U.S. at 321-322.

The pre-1968 New York tax is remarkably similar to the Washington system. A number of separate activities are subject to tax (*e.g.*, selling and manufacturing) but only one tax is paid. Such a system does not provide a direct commercial advantage to local business according to the Court in *Boston Stock Exchange* because:

> [T]he choice of an exchange for the sale of securities that would be transferred or delivered in New York was not influenced by the transfer tax; wherever the sale was made, tax liability would arise. The flow of interstate commerce in securities was channeled neither into nor out of New York by the state tax.

429 U.S. at 330.

Here, too, the flow of selling and manufacturing is channeled neither into nor out of Washington by the state tax. Since the selling tax does not discriminate against interstate commerce and the decision below does not conflict with *Armco*, NCC's appeal of the selling B&O tax does not present a substantial federal question.

C. The Decision Below Sustaining The Manufacturing B&O Tax is Clearly Correct.

Washington's manufacturing B&O tax, by its terms, applies to all manufacturing "within the state." Wash. Rev. Code § 82.04.240. The operation of the multiple activities exemption, Wash. Rev. Code § 82.04.440, limits the application of the manufacturing B&O tax to two situations.

First, if a business manufactures goods in Washington for its own use, instead of buying them (which would result in selling B&O tax upon the seller), it is subject to manufacturing B&O tax. Since there is no sale, no selling B&O tax is paid, and the multiple activities exemption does not operate.[5]

The second situation is where goods are manufactured in Washington and sold outside this state. Since the goods are sold elsewhere, there is no selling B&O tax paid on the sale and the multiple activities exemption does not operate. This is the manufacturing B&O tax at issue here.

1. The manufacturing B&O tax is distinguishable from the wholesaling tax in Armco.

Under the first part of the *Armco* opinion the manufacturing B&O tax appears discriminatory. However, the Court has long recognized that a tax which appears to discriminate will be sustained if it is a "compensating tax." The best known example of a "compensating tax" is the use tax. The use tax appears discriminatory because it applies principally to goods brought in from other states. However, the use tax was sustained by the Court in *Henneford v. Silas Mason Co.*, 300 U.S. 577 (1937) and *Southern Pacific Co. v. Gallagher*, 306 U.S. 167 (1939) because it compensated for the retail sales tax. Together the two taxes resulted in equal treatment of goods purchased or brought into the state. This takes us to the second part of the *Armco* opinion which deals with the "compensating tax" question.

In the second part of *Armco* the majority concludes that West Virginia's wholesaling tax "cannot be deemed a 'compensating tax' for the manufacturing tax." 467 U.S. at 642. NCC asserts that the decision below is in conflict with

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[5]During the period 1980-1984 NCC paid approximately $10,000 in manufacturing B&O tax on goods manufactured in Washington for its own use. These manufacturing taxes are not at issue in this appeal. J.S. I-4, ¶ 17. If NCC had purchased these goods in Washington the seller would have been subject to selling B&O tax in the same amount.

Armco because the Washington Supreme Court ruled that the manufacturing B&O tax is a compensating tax. J.S. 11.

This assertion rests on two points. First, NCC claims that under *Armco* wholesaling and manufacturing can *never* be "substantially equivalent events" and thus, a manufacturing tax can *never* be a compensating tax. J.S. 11 and 12. Second, NCC claims that Washington's tax system is the "mirror image" of West Virginia's. NCC's argument miscontrues *Armco* and mischaracterizes Washington's B&O taxes.

NCC misconstrues *Armco* because the Court did not rule that manufacturing and selling could *never* be "substantially equivalent events." The Court stated: "Here, too, manufacturing and wholesaling are not substantially equivalent events." 467 U.S. at 463. The context makes it clear that the Court is speaking of West Virginia's manufacturing and wholesaling taxes — not manufacturing and selling taxes in general.[6] The Court reached its conclusion by analyzing specific features of the West Virginia tax system. NCC ignores this analysis.

NCC mischaracterizes Washington's B&O taxes because they are not the mirror image of the taxes in West Virginia. Washington's taxes are different and they are different in the critical areas upon which the Court in *Armco* focused its analysis.

The *Armco* Court focused first on the rate of tax. In

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[6]In *Hinson v. Lott*, 75 U.S. 148 (1868) the Court recognized that a selling and manufacturing tax could be compensating taxes. There the taxpayer challenged a tax imposed by Alabama on the introduction of liquor into the state for sale. The rate of tax was fifty cents per gallon. The Court ruled that this tax did not discriminate against interstate commerce because of another tax "imposed by the previous sections of the same act of fifty cents per gallon on all whiskey and all brandy from fruits manufactured in the State." 75 U.S. at 152-153. When the manufacturing tax and selling tax were considered together the Court ruled there was no discrimination because "no greater tax is laid on liquors brought into the State than on those manufactured within it." 75 U.S. at 153. The Court relied on *Hinson v. Lott* to support its decision that the use tax was a compensating tax in *Henneford v. Silas Mason Co.*, 300 U.S. 577, 585 (1937).

West Virginia the rate of manufacturing tax was .0088. 467 U.S. at 641 (n. 5). The rate of wholesaling tax was .0027. 467 U.S. at 640 (n. 2). In analyzing this fact the Court said: "Manufacturing frequently entails selling in the State, but we cannot say which portion of the manufacturing tax is attributable to manufacturing, and which portion to sales." 467 U.S. at 643.

This is not true in Washington. The rate of the selling and manufacturing B&O taxes is virtually identical — .0044. Here, the manufacturing B&O tax compensates completely for the selling B&O tax. In-state and out-of-state manufacturers are treated in an equal manner, which was not true in West Virginia.

The majority in *Armco* next examined the measure of the manufacturing tax. In West Virginia the measure of the manufacturing tax was the value of the products — unless the manufacturing took place partially within and partially without West Virginia. In the latter case the measure was apportioned on the basis of cost.[7] Based on this fact the Court stated:

> The fact that the manufacturing tax is not reduced when a West Virginia manufacturer sells its goods out of State, and that it is reduced when part of the manufacturing taxes place out of State, makes clear that the manufacturing tax is just that, and not in part a proxy for the gross receipts tax imposed on *Armco* and other sellers from other States."

467 U.S. at 643.

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[7]West Virginia Code § 11-13-2(b)(f) states:

It is further provided, however, that in those instances in which the same person partially manufactures, compounds or prepares products within this state and partially manufactures, compounds or prepares such products outside of this state the measure of this tax under this section shall be that proportion of the sale price of the product that the payroll cost of manufacturing within this state bears to the entire payroll cost of manufacturing the product; or, at the option of the taxpayer, the measure of his tax under this section shall be the proportion of the sales value of the articles that the cost of operations in West Virginia bears to the full cost of manufacture of the articles.

This is not true of Washington's manufacturing B&O tax. The measure of this tax is the full "value of the products" manufactured. Also, the measure of both the selling tax and the manufacturing tax is virtually identical. This is because Wash. Rev. Code § 82.04.450 defines "value of the products" in terms of the "gross proceeds derived from the sale thereof." Thus, Washington's manufacturing B&O tax is designed as a compensating tax — that is, a proxy for Washington's B&O tax on selling.

The decision below is consistent with *Armco* because the Washington Supreme Court followed the same analytical steps as the majority. It reached a different conclusion because of differences between the Washington and West Virginia tax systems.

2. Washington's manufacturing B&O tax meets the criteria for a compensating tax and does not discriminate against interstate commerce.

The decision below is also clearly correct in its conclusion that Washington's manufacturing B&O tax meets the "compensating tax" criteria established by the Court. As a result the manufacturing B&O tax does not discriminate against interstate commerce because it does not provide a direct commercial advantage to local business.

In *Maryland v. Louisiana*, 451 U.S. 725 (1981) the Court established the criteria for determining if a tax is a compensating tax. First, the compensating tax must be "designed to meet [the] same ends" as the tax for which it compensates. Second, the two taxes must result in "equal treatment of in-state and out-of-state taxpayers similarly situated." 451 U.S. at 759. A tax which meets these two criteria is valid as a compensating tax and does not discriminate against interstate commerce. Washington's manufacturing B&O tax meets these criteria.

First, the manufacturing and selling B&O taxes are designed to meet the same ends, that is, uniform treatment

of goods manufactured and/or sold in this state. In this respect, the purpose of the manufacturing and selling B&O taxes is similar to the sales and use tax where "a State is attempting to impose a tax on a substantially equivalent event to assure uniform treatment of goods and materials to be consumed in the State." *Maryland v. Louisiana*, 451 U.S. at 759.

Second, the manufacturing and selling B&O taxes result in equal treatment of in-state and out-of-state taxpayers similarly situated. A business that manufactures and/or sells in Washington pays the same amount of Washington tax.

Thus, when NCC manufactures and sells $1,000 of goods in Washington, it pays selling B&O tax of $4.40 ($1,000 x .0044). When NCC manufactures those goods elsewhere and sells them in Washington, it also pays selling B&O tax of $4.40. When NCC manufactures those goods in Washington and sells them elsewhere, it is subject to manufacturing B&O tax of $4.40. Indeed, when NCC manufactures those goods in Washington for its own use, the manufacturing B&O tax is the same.

Unlike the wholesaling tax in West Virginia, Washington's manufacturing B&O tax meets the compensating tax criteria. The manufacturing B&O tax does not discriminate against interstate commerce because it neither discourages interstate commerce nor improperly encourages interstate businesses to direct their commerce into Washington. For this reason the decision below is clearly correct and does not raise a substantial federal question.

D. The Concept of Internal Consistency Does Not Invalidate The Selling and Manufacturing B&O Taxes.

1. Armco did not graft the concept of internal consistency onto the discrimination prong of the Commerce Clause test.

NCC also claims that the Washington Supreme

Court's decision is inconsistent with *Armco* because it did not apply the concept of "internal consistency" to invalidate both of Washington's B&O taxes. J.S. 9. Essentially, NCC argues that *Armco* grafted the concept of internal consistency onto the discrimination prong of the Commerce Clause test.

NCC's argument amounts to this: even though the selling B&O tax is imposed on *all* sellers, the concept of internal consistency renders that tax discriminatory. Thus, NCC would assert that under *Armco* the West Virginia *manufacturing* tax, which was applicable to *all* manufacturers, would have been held discriminatory. Internal consistency is discussed in the third part of the majority's opinion. 467 U.S. at 644. NCC takes the Court's discussion completely out of context. The decision below is faithful to the majority's analysis in *Armco*.

The Court's discussion of internal consistency in *Armco* was in response to West Virginia's argument that Armco be required "to prove actual discriminatory impact." 467 U.S. at 644.

The Court rejected this argument. According to the majority, a showing of "actual discriminatory impact" by reason of another state's taxes:

> [I]s not the test. In *Container Corp. of America v. Franchise Tax Board*, 463 U.S. 159, 169 (1983) the Court noted that a tax must have "what might be called internal consistency — that is the [tax] must be such that, if applied by every jurisdiction," there would be no impermissible interference with free trade.

467 U.S. at 644.

The internal consistency test in *Container Corp. of America v. Franchise Tax Board*, 463 U.S. 159 (1983), does not require one to prove actual discriminatory impact by pointing to another state's tax system. In *Armco*, the Court stated: "A similar rule applies where the allegation is that a tax on its face discriminates against interstate commerce." 467 U.S. at 644.

The "similar rule" is not the concept of internal consistency. It is the rule that "actual discriminatory impact" need not be shown where a tax discriminates on its face.

The rule that "actual discriminatory impact" need not be shown is necessary because "Any other rule would mean that the constitutionality of West Virginia's tax laws would depend on the shifting complexities of the tax codes of 49 other States * * * *" 467 U.S. at 644-645.

Thus, the majority did not graft the concept of "internal consistency" onto the discrimination prong of the Commerce Clause test.

2. The decision below is consistent with the decisions of this Court, both before and after Armco, which have dealt with the issue of internal consistency.

The Washington Supreme Court's decision is clearly correct. It is consistent with the Court's decisions both before and after *Armco* where the Court has refused to apply an internal consistency type test to the discrimination prong of the Commerce Clause. Specifically, the Court has refused to apply such a test in its analysis of use taxes challenged under the Commerce Clause.[8]

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[8]Additional proof that the Court has not grafted internal consistency onto the discrimination prong of the Commerce Clause can be found in *Boston Stock Exchange*, 429 U.S. 318 (1977) and *Westinghouse v. Tully*, 466 U.S. 388 (1984).

In *Boston Stock Exchange* New York's pre-1968 transfer tax system would not pass NCC's proposed internal consistency test. If another state had that tax system, interstate commerce could pay two taxes (e.g., one on the sale in the other state and a second on the delivery of securities in New York). If sale and delivery both took place in New York there would be only one tax. The Court concluded that this pre-1968 system did not discriminate because it was "neutral as to in-state and out-of-state sales * * * The flow of interstate commerce in securities was channeled neither into nor out of New York by the state tax." 429 U.S. at 330.

On the other hand, in *Westinghouse v. Tully* the Court struck down a tax as discriminatory — even though it *had* internal consistency. The question before the Court was whether a credit to New York's

In all sales and use tax systems the taxing state (e.g., State A) imposes either its sales tax or its use tax on goods. The state does not impose both taxes on the same goods. This is normally accomplished by State A exempting from its use tax those items which have already been subject to its sales tax, upon the sale to the present user. Because of this exemption, the use tax normally applies only to items which the user has purchased outside State A (e.g., in State B) beyond the reach of State A's sales tax.

State A's use tax violates NCC's proposed internal consistency test if it provides no exemption or credit for sales taxes paid in other states (e.g., State B). Thus, goods purchased and used in State A are subject to one tax — State A's sales tax. Goods purchased in State B and brought into State A are subject to two taxes — State B's sales tax and State A's use tax.

Precisely such an internally inconsistent sales and use tax system was before this Court in *Southern Pacific v. Gallagher*, 306 U.S. 167 (1939) where the Court considered a challenge to California's use tax.

If the California sales and use taxes were placed in another state, goods purchased in that other state and brought into California would bear two taxes — retail sales tax and use tax; for the California use tax allowed no credit or other offset for another state's sales tax. Goods purchased in California and used in California would bear only one tax — retail sales tax. Thus, internal consistency was the basis of the taxpayer's challenge.

If lack of internal consistency is a form of unconstitutional discrimination the Court should have invalidated California's use tax. It did not. Instead, the Court ruled

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franchise tax discriminated against interstate commerce. The credit was perfectly apportioned, i.e., it had internal consistency. New York attempted to defend the credit on this basis. Despite its internal consistency the Court struck down the credit under the discrimination prong. The fact that the tax was fairly apportioned, i.e., internally consistent, did not save it. As the Court observed: " 'Fairly apportioned' and 'nondiscriminatory' are not synonymous terms." 466 U.S. at 399.

that: "[T]his is not a discrimination in the law." 306 U.S. at 172.

The mechanics of NCC's proposed internal consistency test require one to assume that the challenged taxes exist in another state. This the Court in *Southern Pacific* specifically refused to do because "It will be time enough to resolve that argument 'when a taxpayer paying in the state of origin is compelled to pay again in the state of destination.' " 306 U.S. at 172 (quoting *Henneford v. Silas Mason Co.*, 300 U.S. 577, 587 (1937)).

In *Williams v. Vermont*, ___ U.S. ___, 105 S.Ct. 2465 (1985) the Court specifically affirmed its earlier ruling in *Southern Pacific*. *Williams* is particularly important because it was decided after *Armco*.

Williams invalidated Vermont's use tax on motor vehicles. The Vermont sales and use tax system would have failed NCC's proposed internal consistency test as applied to nonresidents. A nonresident would pay two taxes — the sales tax in the state of purchase and Vermont's use tax. A Vermont resident, buying in Vermont, would pay only Vermont sales tax.

The Court ultimately struck down the tax because the distinction between residents and nonresidents violated the equal protection clause. 105 S.Ct. at 2472. However, the Court specifically reaffirmed *Southern Pacific* and refused to apply an internal consistency type test. In the words of the Court:

> This Court has expressly reserved the question whether a State must credit a sales tax paid to another State against its own use tax * * * Appellants urge us to hold that it is a constitutional requirement. Brief for Appellants 31-35. Once again, however, we find it unnecessary to reach this question.

105 S.Ct. at 2471.

Williams is significant because *Armco* was specifically brought to the Court's attention. The pages of the

Brief for Appellant (31-35) referred to by the Court discuss its earlier opinion in *Armco*.

Southern Pacific and *Williams* confirm the fact that the Court has not grafted the internal consistency test onto the discrimination prong of the Commerce Clause.

Moreover, NCC is in precisely the same position as the taxpayer in *Southern Pacific*. Just as that taxpayer could show no doubling up between California's use tax and another state's sales tax, so too, NCC cannot show any doubling up between Washington's gross receipts tax — be it selling tax or manufacturing tax — and the counterpart tax of another state.

Like NCC here, the taxpayer in *Southern Pacific* was attempting to escape from an otherwise constitutionally permissible tax burden simply because of a purely hypothetical doubling up of taxes which in fact did not exist. The Court refused to allow such an easy escape. NCC should fare no better.

Following the approach adopted in *Southern Pacific* and *Williams*, this Court should decide the question of whether an internally inconsistent tax system is *per se* discriminatory and thus violative of the Commerce Clause only in a case in which an actual doubling up can be shown. *Armco* does not require that it do otherwise.

II. NCC MISREPRESENTS THE FACTS PERTAINING TO ITS APPORTIONMENT CLAIM.

NCC challenges the apportionment of the selling and manufacturing B&O taxes. J.S. 7 (n. 3). However, NCC does not claim that the Washington Supreme Court's decision on apportionment presents a substantial federal question. Since *Armco* did not concern apportionment, the decision below, on apportionment, cannot be in conflict with *Armco*. We address the apportionment issue only to correct two misstatements made by NCC which may mislead the Court.

First, NCC states that the parties have stipulated to the existence of a multiple tax burden in this case. J.S. 6 and 7 (n. 4). This is incorrect.

The parties stipulated that NCC is subject to taxes in other states measured by NCC's: "[G]ross income of every kind and from every source * * * minus certain deductions * * * and multiplied by an apportionment factor." J.S. I-3 and 4, ¶¶ 14 and 15.

The fact that NCC pays taxes measured by net income (gross income minus deductions) in other states, in addition to Washington's selling and manufacturing B&O taxes, does not constitute a multiple burden. The Court rejected this argument in *Exxon Corp. v. Department of Revenue of Wisconsin*, 447 U.S. 207 (1980). *Exxon* concerned formulary apportionment of income Exxon earned on oil and gas extracted in other states. Exxon argued that it was subject to a multiple burden because those other states imposed severance taxes on the extraction of the oil and gas. 447 U.S. at 228.

The Court ruled that this did not constitute a multiple burden because "Severance taxes, however, are directed at the gross value of the mineral extracted or the quantity of production rather than the net income derived from the production activities." 447 U.S. at 228 (n. 12).

The same is true of Washington's selling and manufacturing B&O taxes. These taxes are on the privilege of engaging in business. They are directed at the gross proceeds of sale or the value of the products manufactured.

Thus, NCC is in precisely the same position as the taxpayer in *General Motors Corp. v. Washington*, 377 U.S. 436 (1964). It has not demonstrated a multiple tax burden.

NCC's second misstatement is its assertion that the selling and manufacturing B&O taxes are unapportioned. J.S. 2. Again, this statement is incorrect.

Washington apportions its selling and manufacturing B&O taxes through the use of allocation. For example, in 1983 NCC's worldwide sales were approximately $1.552 billion. Of this amount approximately $110 million was

allocated to Washington as the "gross proceeds of sales" in this state. J.S. I-3, ¶ 13.

Washington taxes none of NCC's receipts from manufacture or sales conducted outside this state, e.g., manufacture in Minnesota, sale in New York. Washington also attributes none of the income of any of NCC's subsidiaries or affiliates to NCC, itself, either on the basis of a unitary business, as was the case in *Container Corp.*, 463 U.S. 159 (1983), or on any other basis.

In *Standard Pressed Steel Co.*, 419 U.S. 560 (1975) the Court ruled that the selling B&O tax was "apportioned exactly to the activities taxed." 419 U.S. at 564. The Court cited this quotation from *Standard Pressed Steel* with approval in *Moorman Manufacturing Co. v. Bair*, 437 U.S. 267, 280 (1978).

The Court has also approved imposition of a manufacturing tax measured by the selling price of the goods. *American Manufacturing Co. v. St. Louis*, 250 U.S. 459, 462-463 (1919) and *Freeman v. Hewitt*, 329 U.S. 249, 258 (1946).

In summary, NCC has failed to establish the existence of a multiple tax burden. Washington's selling and manufacturing B&O taxes are fairly apportioned. The Court's decisions in *General Motors* and *Standard Pressed Steel* are dispositive of NCC's apportionment claim. Thus, the decision below is clearly correct and does not present a substantial federal question.

CONCLUSION

For the reasons given above, this appeal should be dismissed or, in the alternative, the judgment should be affirmed.

DATED this 3rd day of July, 1986.

Respectfully submitted,

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